

review of Company rates in an efficient and predictable manner. With the implementation of a uniform COS methodology, rate submissions should be able to be accomplished in an efficient and effective manner. While the Plan establishes alternative ratemaking for CVPS's costs and expenses, it does not limit the Company's obligation to act prudently in its provision of service to customers. Nor does the Plan contain changes to the Company's approved rate design. Furthermore, the Plan works in concert with the Company's SQRP and Asset Management Plan. When taken together, these features promote the establishment of just and reasonable rates for all classes of Company customers under the Plan. Deehan pf. at 30-31.

c. Safe and Reliable Service (§ 218d(a)(3)).

136. The Plan results in the delivery of safe and reliable service through incorporation of three key ongoing customer service initiatives at CVPS: its Asset Management Plan; its commitment to the introduction of smart metering technologies; and its effort to improve customer performance as measured primarily under its Service Quality and Reliability Plan ("SQRP"). While the Company's ability to meet these objectives is not assured under the Plan, CVPS believes that the Plan provides it a reasonable opportunity to work to improve service for customers through innovation and improved operational efficiencies that the terms of the Plan are designed to encourage. Kraus/White pf. at 3.

137. The Plan is designed to provide CVPS revenues sufficient to permit it to operate so as to provide for the delivery of safe and reliable service to customers. The Company has based the proposed dead bands and caps on targets that it believes are aggressive enough to promote efficient operation in those areas within management's and employees' influence, and which are adequate to enable the Company to maintain service quality. The Plan also contains

provisions which allow for a review and evaluation of the Plan where problems can be identified and addressed with the input of the Department of Public Service. Deehan pf. at 31.

d. Incentives that Advance State Energy Policy (§ 218d(a)(4)).

138. The Plan provides incentives for innovations and improved performance that advance state energy policy such as increasing reliance on Vermont-based renewable energy and decreasing the linkage between sales and earnings. The Plan allows the Company to pursue innovations and policy initiatives without undue financial risk or the need for a traditional rate filing. Deehan pf. at 2; Findings 18-64 and 67-123, above.

139. Vermont has established a variety of programs to promote the development of new renewable generation. These include net-metering, Rule 4.100, and the SPEED Program. Voluntary renewable pricing programs may also be authorized for electric utilities. When designing the CVPS Plan, the Company considered these initiatives so as to assure that the Plan's ratemaking worked to harmonize the Company's incentives with those of its customers. Deehan pf. at 31-32.

140. With respect to net-metering, the Plan contains provisions to decouple utility earnings from customer loads. Disincentives to the implementation of net-metered generation will thereby be reduced from the Company's perspective. Deehan pf. at 32.

141. With respect to new renewable generation, the Plan contains terms to permit the adjustment of power costs to allow the Company to include purchases from new sources. In this way, the ratemaking called for under the Plan allows the Company to recognize incremental purchases in a timely manner. This is true for purchases made under the SPEED program as well

as under Rule 4.100. Deehan pf. at 32.

142. Also under the Plan, CVPS proposes to continue to offer its CowPowerTM Program. Nothing in the alternative ratemaking called for under the Plan would create a disincentive for the Company to offer innovative programs to encourage use of new Vermont renewable resources. Deehan pf. at 32.

143. The Plan contains decoupling mechanisms so that rates are based on anticipated customer loads. As conservation, efficiency or load management initiatives are implemented, the expected load impacts will be recognized in ratemaking. This feature helps to reduce the linkage between the Company's financial success between rate cases and its sales to the end use customers. In this way, the Plan's adjustment mechanisms work to provide revenue to support operations and permit the Company to earn a reasonable return even when its loads are reduced to promote energy efficiency objectives. Deehan pf. at 32-33.

e. Improved Quality of Service, Reliability, and Service Choices (§ 218d(a)(5)).

144. The Plan promotes improved quality of service and reliability service through incorporation of the Company's SQRP and the improvements proposed by the Company. Deehan pf. at 2; Findings 18-64 and 67-123, above.

145. The Plan has been designed to permit continued improvement in the provision of safe and reliable service under the Company's SQRP plan. In addition, CVPS will complete the actions approved in Docket No. 7095, including the filing of a long-term plan for its retail rate design and service offerings as detailed in its MOU with the DPS in that docket. The Plan includes the Company's commitment to the development of an annual fixed power price option

for customers who do not want to be served with rates that are subject to the PCAM mechanism.

The Company's Petition provides that this offering will be filed for review with the goal of offering optional service starting with the second annual Base Rate filing under the Plan. Deehan pf. at 33.

146. The Plan has also been developed to help CVPS to implement "smart-metering" as quickly as it prudently can. With the advent of smart-metering and new AMI network infrastructure, the rate design and demand response opportunities available to CVPS and its customers will be enhanced. The features of the Plan that are designed to promote financial stability should help CVPS to move forward on its strategic initiatives, like the introduction of smart-metering that are being designed to serve the Company's long-term goals of meeting customer needs at least-cost, including enhanced options to create more customer choices. Deehan pf. at 33-34.

f. Encourage Innovation in the Provision of Service (§ 218d(a)(6)).

147. The Plan encourages innovative provision of service by creating incentives to reduce costs, such as through innovative and efficient approaches in the way it operates. Deehan pf. at 2; Findings 18-64 and 67-123, and 144-146, above.

g. Reasonably Balanced System of Risks and Rewards (§ 218d(a)(7)).

148. The Plan establishes a reasonably balanced system of risks and rewards that encourages the Company to operate as efficiently as possible using sound management practices, by reducing the Company's cost of capital, by flowing this beneficial impact through to

customers, and by creating cost control incentives. Deehan at 2; Findings 18-64 and 67-123, above.

149. The ratemaking called for under the Plan is designed to focus management and employees on the goals of enhanced reliability, service and operational efficiency in the provision of service to customers. The dead bands and caps established under the Plan were carefully developed to encourage performance and promote greater alignment between opportunities to control costs and risks, and incentives are in place to encourage the Company to do so. The Plan attempts to balance the interest and ability of management to control costs, where able, against the financial performance risks to the Company of costs that are largely outside of management control. When these features are combined, CVPS believes that its proposal appropriately creates a balanced system of risks and rewards that encourages the Company to operate efficiently using sound management practices. Deehan pf. at 34-35.

h. Reasonable Opportunity to Earn a Fair Rate of Return (§ 218d(a)(8)).

150. The Plan provides a reasonable opportunity to earn a fair rate of return by providing for periodic rate adjustments to reflect differences between target and actual costs subject to the PCAM and ESAM. Deehan pf. at 2; Findings 18-64 and 67-123, above.

151. The Plan has been designed to provide for sound and economical management, by challenging management to act to promote the long-term efficiency of its provision of service to customers. This includes the use of tight controls for costs most directly within the purview of management and features to manage volatile power costs while establishing incentives for the effective management of market risks. When these Plan features are considered in total, they

should create an opportunity for CVPS to earn a fair return under sound and economical management. Deehan pf. at 35.

i. Impact on Accounting (§ 218d(m)(1)).

152. The Plan will not have an adverse impact on the Company's eligibility for rate-regulated accounting in accordance with generally accepted accounting standards, because the Company will continue to have an opportunity to recover its costs and because rates will continue to be based on costs. Keefe/Cook pf. at 3.

153. The Plan as designed meets the three qualifying criteria under FAS 71 ("Accounting for the Effects of Certain Types of Regulation") and also the three criteria under EITF Issue No. 92-7 ("Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs"). Keefe/Cook pf. at 8-9.

j. Preserve the Availability of Equity and Debt Capital Resources (§ 218d(m)(2)).

154. The Plan reasonably preserves the availability of equity and debt capital resources to the Company on favorable terms and conditions, because Wall Street analysts and rate agencies strongly favor power adjustment clauses that permit rates to reflect costs on a regular basis, and because the Company's risks are reduced. Keefe/Cook pf. at 3.

155. The financial community's perception of CVPS as less financially risky, due to the reduced uncertainty and improved timeliness of cost recovery, the PCAM, the ESAM and the resultant increased possibility of an improved credit rating, will help support the Company's access to capital on favorable terms and conditions. Keefe/Cook pf. at 8.

156. Approval of the Plan as filed has the potential to improve the Company's chances

of achieving an investment-grade credit rating. CVPS's Plan is similar in structure, including cost recovery mechanisms, to GMP's alternate regulation plan. Upon issuance of that Order, S&P published an assessment on January 10, 2007 entitled *Green Mountain Power's New Rate Order Should Bolster Credit Quality*. In it, S&P states:

"Standard & Poor's Ratings Services views the rate order as favorable to GMP, as it provides incremental cash flow and reduced earnings volatility through rate design, despite the lower allowed ROE."

In particular, S&P discusses GMP's quarterly power cost adjustment mechanism:

"Standard & Poor's considers this mechanism to be supportive of credit quality, because it provides for timely recovery of unpredictable, fuel-related costs without receiving approval from regulators for fuel cost changes."...."Recovery of these costs also can improve a utility's ability to earn its authorized ROE, and the amount of working capital required for cost deferrals and future recovery decreases with frequent adjustments."

As a result of these views, and in particular the power cost recovery provided under GMP's alternative regulation plan, S&P lowered the risk factor it applies to GMP's power contract costs in its calculation of off-balance-sheet debt from 50% to 25%. Keefe/Cook pf. at 5-6.

157. It is reasonable to expect S&P to treat CVPS similarly given the similarities in alternate regulation plans and power cost adjustment mechanisms. For CVPS, this lower risk factor would significantly reduce the off-balance-sheet debt that S&P uses to adjust the Company's financial credit metric calculations. CVPS expects that from a credit rating agency perspective, the positive impact of lower off-balance-sheet debt will more than offset the reduction in cash flow resulting from a 50-basis point reduction in the allowed ROE and unrecovered Subcap costs, and improve the Company's financial credit metrics on a net basis. Keefe/Cook pf. at 6-7.

k. Reasonable Sharing of Savings with Ratepayers (§ 218d(b)).

158. The Plan provides that any savings resulting from the Plan will be shared with ratepayers through the combination of the Base Rate adjustments and the bands included in the ESAM and PCAM. Deehan pf. at 2; Findings 18-64 and 67-123, above.

159. Where savings result from the implementation of the Plan, the savings will be shared with ratepayers primarily through the operation of the Earnings Sharing Adjustment Mechanism within rate years and via the annual filing of Base Rates. Deehan pf. at 35.

160. The Plan contains an additional sharing mechanism. It provides that CVPS will contribute 10% of any earnings within the dead band in excess of the Board-approved rate of return on equity to a to-be-established low income bill assistance program. Deehan pf. at 35-36.

B. Discussion

The Plan proposed by CVPS is the second alternative regulation plan for an electric utility in Vermont.¹⁹ Alternative regulation for electric and gas utilities is authorized by Section 218d of Title 30. That section also delineates a series of findings that the Board must make before it can approve an alternative regulation plan. Specifically, Section 218d(a) requires that the Board find that an alternative regulation plan will:

- (1) establish a system of regulation in which such companies have clear incentives to provide least-cost energy service to their customers;

¹⁹ The Board has previously authorized alternative regulation plans for Verizon New England Inc., d/b/a Verizon Vermont, Vermont Gas Systems, and Green Mountain Power Corporation. *Investigation into an Alternative Regulation Plan for New England Telephone*, Docket Nos. 6167/6189, Order of 3/24/00; *Investigation into Successor Incentive Regulation Plan for Verizon*, Docket No. 6959, orders of 9/26/05 and 4/27/06; *Petition of Vermont Gas Systems, Inc. for approval of an alternative regulation plan*, Docket No. 7109, Order of 9/21/06; *Petition of Green Mountain Power Corporation for approval of an alternative regulation plan*, Docket No. 7176, Order of 12/22/06.

- (2) provide just and reasonable rates for service to all classes of customers;
- (3) deliver safe and reliable service;
- (4) offer incentives for innovations and improved performance that advance state energy policy such as increasing reliance on Vermont-based renewable energy and decreasing the extent to which the financial success of distribution utilities between rate cases is linked to increased sales to end use customers and may be threatened by decreases in those sales;
- (5) promote improved quality of service, reliability, and service choices;
- (6) encourage innovation in the provision of service;
- (7) establish a reasonably balanced system of risks and rewards that encourages the company to operate as efficiently as possible using sound management practices; and
- (8) provide a reasonable opportunity, under sound and economical management, to earn a fair rate of return, provided such opportunity must be consistent with flexible design and alternative regulation and with the inclusion of effective financial incentives in such alternatives.

Under subsection (m), in the case of an investor-owned utility such as CVPS, the Board must also find that the Plan will:

- (1) not have an adverse impact on the electric company's eligibility for rate-regulated accounting in accordance with generally accepted accounting standards if applicable; and
- (2) reasonably preserve the availability of equity and debt capital resources to the company on favorable terms and conditions.

In addition, subsection 218d(b) requires that "if savings result from alternative regulation, the savings shall be shared with ratepayers as determined by the board." Finally, Section 218d(h) permits the Board to establish, by rule or order, standards by which to assess the effectiveness of alternative regulation plans.

Alternative regulation, while authorized by statute, is an option, not a requirement. As

the Board has observed in the past, any meaningful analysis of alternative regulation must consider the opportunity cost of continuing under additional regulation.²⁰ This means that we should expect that both the Company *and* its customers will benefit from alternative regulation.

CVPS argues that its Plan will benefit both itself and its customers. In particular, the CVPS Plan provides a number of customer benefits because it: (1) avoids the drain on resources resulting from traditional rate cases, which are inefficient, lengthy and expensive; (2) reduces the uncertainty associated with the timing and magnitude of rate changes; (3) reduces the mismatch between costs and rates due to regulatory lag; (4) provides improved cost reduction incentives; and (5) reduces rates through the incorporation of a lower ROE and a sharing of other cost savings.²¹

The Department challenges the incentive formulations in the Plan, arguing that the cost caps and the ESAM dead bands and sharing bands:

- have the potential to result in unjust and unreasonable rates;
- create a degree of unfairness among alternative regulation plans and do not appear to accomplish the objectives of an alternative regulation program; and
- do not appear to provide motivation to control costs, stimulate efficiencies and superior earnings performance.²²

Consequently, the Department proposes revisions to ensure that the statutory criteria will be satisfied. The Department seemingly argues the revisions are needed to satisfy the two criteria designed to ensure:

²⁰ See Docket No. 6959, Order of 9/26/05 at 23; Docket Nos. 7175/7176, Order of 12/22/06 at 27-28.

²¹ Deehan pf. at 2-3; Exh. CVPS-WJD-2; Keefe/Cook pf. at 3.

²² Behrs pf. at 8.

- (1) just and reasonable rates; and
- (2) effective incentives and motivation to control costs.²³

But for these two criteria, the evidence relating to the other statutory criteria is largely undisputed. No party seems to question that the CVPS Plan will:

- (3) permit the Company to deliver safe and reliable service;
- (4) offer incentives for innovations and improved performance that advance state energy policy such as increasing reliance on Vermont-based renewable energy and decreasing the extent to which the financial success of distribution utilities between rate cases is linked to increased sales to end use customers and may be threatened by decreases in those sales;
- (5) promote improved quality of service, reliability, and service choices;
- (6) encourage innovation in the provision of service; and
- (7) provide a reasonable opportunity, under sound and economical management, to earn a fair rate of return.

Also, no party disputes that the Plan will:

- (8) not have an adverse impact on the electric company's eligibility for rate-regulated accounting in accordance with generally accepted accounting standards if applicable;
- (9) reasonably preserve the availability of equity and debt capital resources to the Company on favorable terms and conditions; and

²³ Behrns pf. at 6. Due to the incentives dispute, the Department would likely also argue that the CVPS Plan does not establish a reasonably balanced system of risks and rewards that encourages the Company to operate as efficiently as possible using sound management practices.

- (10) if savings result from alternative regulation, the savings will be shared with ratepayers.

In the following sections, we consider each of the objections raised by the Department. In summary, the Company believes that the Plan as proposed by CVPS is reasonable and should be approved. The Plan offers several benefits. It will, over time, reduce some of the time and expense associated with litigated rate adjustments. Instead of the traditional filing of rate increases that often lead to contested-case proceedings, CVPS will have more frequent, but also more limited, rate adjustments. The Board, Department, and parties will have responsibilities to evaluate these filings; however, we expect that the overall burden will be less than under traditional regulation, while still ensuring that rates are just and reasonable. In this regard, the Company's agreement to review by an independent third party should help address some of the workload and timing considerations.²⁴

The Plan also will help CVPS meet the long-term energy goals of the state – namely the provision of high quality service at least-cost. The Plan includes meaningful incentives for the Company to control costs. One of the major benefits of the Plan is the likelihood that it is likely to improve CVPS's financial ratings and credit worthiness. This will enhance CVPS's ability to pursue a broad range of options to replace the large power contracts that will begin to expire in 2012. It should also reduce CVPS's cost of capital and collateral requirements, producing savings that can be passed on to ratepayers.²⁵

²⁴ Exh. CVPS-WJD-2 at 3. Accord Docket No. 7175/7176 Order at 28-29.

²⁵ Keefe/Cook pf. at 5-6. Cf. Docket Nos. 7175/7176 Order at 29.

1. Incentives to Provide Least Cost Services

Section 218(a)(1) requires that the Board find that an alternative regulation plan establish a system of regulation providing companies with “clear incentives to provide least-cost service to their customers.” The Department claims that the Plan will not provide sufficient incentives to control costs. To the contrary, the Department asserts the incentives “appear to result in a relatively 'risk free' level of business and financial risk that is inconsistent with sound and responsible regulatory policy.”²⁶ The Department objects to the “Unicap” for six reasons:²⁷

- First, the filing indicates this is an aggregate cap covering the total power and non-power components of the revenue requirement. In reality it appears to cover only non-power cost increases. The Unicap functions as a cap on non-power costs and not on the total revenue requirement and not on power costs.
- Second, CVPS has provided no creditable supporting detail regarding how the 8 mil Unicap rate was determined and there are no provisions under the Plan to update the Unicap rate for changes in operations, in rate base additions or for productivity impacts, power costs or for price level changes that may occur over the remaining life of the plan.
- Third, when applying the 8 mil Unicap, CVPS testimony does not convincingly and clearly support the need for 7+% annual rate increases due to potential 16% annual increases in non-power costs.
- Fourth, the filing does not demonstrate how the Unicap or Subcap will function as an incentive to stimulate cost control and bring about effective efficiency improvements.
- Fifth, the Unicap, as proposed by CVPS, has a dual purpose of limiting power cost

increase recovery during the rate year and to limit overall non-power cost increases in a subsequent rate year. This is confusing and needs to be clarified. Any power cost increases not recoverable through the Unicap in a current rate year will be recovered in a later rate year. This effectively excludes the power cost adjustments from the Unicap, with the Unicap then meeting its second function of limiting non-power cost changes in the rate year.

- Finally, regarding the Unicap, if the Board adopts the Modified Plan, CVPS's non-power costs could increase up to approximately \$19 million or 16% per year while power cost increases are deferred. This translates into approximately a \$19 million or 7% annual rate increase for 2009 and 2010 and potentially for two additional years if the Plan is extended. If the Business Process Review consultants determine that CVPS does in fact need an additional 18 employees, this would boost the 2009 rate increase by approximately \$2.4 million for a total rate increase of about \$21 million or 8% and an overall increase in non-power costs of \$21 million or 18%. These rate increases do not include CVPS forecasted increases in power costs over the remaining term of the Plan.

The Company responds to each of the Department's objections to the Unicap as follows:

- The first statement is not factually correct. The Department provides no reference to the portion of the Plan supporting this conclusion. The Unicap limits both non-power costs and power costs, whether through base rates or through the power cost adjustment mechanism.

²⁶ Behrns pf. at 8.

- With respect to the second point, the Company chose a level for the Unicap that would result in lower maximum overall rate increases to consumers than either of the other Vermont energy company plans. The CVPS Plan caps the total annual increase to customers from base rates and power adjustments, thereby providing insurance to consumers against rate shocks. Productivity impacts are accounted for in the design of the Subcap.
- With regard to the third point, the issue at hand is the setting of cost caps, not the filing for approval of a cost of service. On an annual basis, the Department and Board will have the opportunity to review the Company's Cost of Service, based on an historic test year adjusted for known and measurable changes. At these times, the Department and Board may choose to investigate whether the Company is operating as efficiently as possible using sound management practices. The fourth point seems to be the Department's chief concern and the Company has explained the Plan's incentives to control costs and how they are balanced with the other objectives of alternative regulation. In fact, the Department's witness testified that it seeks a \$5 million reduction in the Company's costs, regardless of the results of the Business Process Review. Upon examination, the witness could not articulate any areas in the Company's COS where such savings could be achieved. Tr. 7/10/08 at 142 (Behrns). The Department's goal appears to be simply and arbitrarily a revenue cut, regardless of the real impact on the Company's cash flow, Asset Management Plan, AMI or access to capital. The Company submits that is not an appropriate goal of alternative ratemaking.

²⁷ Behrns pf. at 8-11.

- The fifth point is not factually correct and is not supported by reference to the proposed Plan. The Unicap limits both non-power costs and power costs in the rate year, whether through base rates or through the power cost adjustment mechanism.
- The final point is a hypothetical maximum rate increase scenario which is not consistent with the Company's forecast. Even as a hypothetical maximum rate increase scenario, these rate increases are lower than what would be allowed under either the GMP or the VGS Plans. Moreover, the Department has overstated the impact of the additional 18 employees. First, the expected cost of 18 employees would be \$1.4 million fully loaded for benefits, not \$2.4 million. Second, these costs would not boost the rate increase in 2009 or any other year. These costs would be subject to the Unicap and, potentially, the Subcap.

In summary, the Department's objections to the Unicap lack a sound foundation. The Unicap provides a reasonable incentive for the Company to control overall costs to guard against rate shock to customers during the Plan term. It provides the Company with an added incentive to manage power costs, which make up the largest share of the cost of service, so as to provide least cost service to customers overall.²⁸

Regarding the Subcap, the Department objects on the following grounds:²⁹

- The Subcap expense categories are too narrow. They are only some of the non-power operating expenses, making up only about \$40 million or 54% of non-power controllable

²⁸ The Unicap creates the risk that unplanned power cost increases, not covered as an Exogenous Factor, could not be recovered in a timely way under the PCAM and would have to be deferred. This could harm the Company's cash flow and related credit metrics, thereby jeopardizing the Company's credit rating. The Company acknowledges this as a risk that would have to be managed. If the Board determines the risk of the Unicap exceeds the purported benefits, the Company believes the CVPS Plan would continue to satisfy the statutory criteria without the Unicap as a feature.

operating expense based on the Company's 2008 rate year cost of service.

- The cap would change each year based on changes in the consumer price index, without adjustments.

In lieu of the Unicap and Subcap, the Department proposes a “non-power cost cap.” The Department further proposes that the incremental non-power cost cap be set at \$6.2 million for 2009 and \$8.7 million for 2010. The Department did not provide a valuation for 2011 and 2012. According to CVPS, applying the Department's cost cap methodology to 2011 would result in an incremental non-power cost cap of \$10.2 million. In each of these years, the Company's forecasted non-power costs exceed these amounts and therefore the Department's proposed caps would result in significant disallowed costs.

The non-power cap Witness Behrns proposes will not generate a base of revenues sufficient to support the continued implementation of the Company's Asset Management Plan and it will eliminate the Company's ability to earn its allowed rate of return. This is especially the case for 2009, as shown in Exhibit CVPS-Rebuttal-PJK/RDC-3, where the Company would experience millions in disallowed costs in that year. Given the work the Company has undertaken with the Department to hire an independent consultant to conduct a Business Process Review as required by the 2008 MOU, the Company submits that it would be premature and potentially reckless to adopt a cost cap in spite of credible Company testimony that it is not possible to find the requisite efficiencies without seriously affecting service quality and reliability. As a result, rather than being incented to manage the business efficiently, the Company would be incented to either: (i) dramatically delay its Asset Management Plan efforts

²⁹ Behrns pf. at 12.

including its reliability-driven operating efforts; or (ii) spend as needed while knowing that, no matter what it does, it will earn at or near the low end of the ESAM – with virtually no hope of utilizing increased management efficiency to move above that floor. The effect that could have is to effectively remove the incentive for the Company to prudently cut marginal costs to improve its earnings, due to the magnitude of the projected disallowed costs. Moreover, the financial community at large, and the credit rating agency Standard & Poor's in particular, may be skeptical of the value of an alternative regulation plan that, as designed, produces materially large cost disallowances, deferred recovery of earnings and effectively removes incentives for the Company to improve its financial results and to earn its allowed return.

The Business Process Review will be available to the Board, Department and the Company before the Company is required to file its 2009 Base Rate cost of service. Under the Docket No. 7321 MOU, the Company is expected to implement all the recommendations that will be contained in the Review to improve the Company's cost structure or identify areas of improvement or cost reduction. To the extent cost reductions are identified by the Review as achievable during the 2009 rate year, the Company will have an incentive to include them in the cost of service. Otherwise, the Company would risk the suspension of the Base Rate change under the Plan or a rate investigation.³⁰ Therefore, the Company believes it is safe for the Board to reject the cost cap amounts suggested by the Department.

In contrast, the Department's proposal, as shown on Exh. Rebuttal-PJK/RDC-6, page 2, line 87, results in significant disallowances in each of the Plan years. As explained above, the DPS proposal will not generate a base of revenues sufficient to support the continued

³⁰ The Board has the authority to open a rate investigation rather than suspending the annual Base Rate

implementation of the Company's Asset Management Plan and it will eliminate the Company's ability to earn its allowed rate of return.

If the Board determines that a non-power cost cap should be established in lieu of the proposed Unicap and Subcap, the Company recommends "Option #3 – Lowry reb. Alternative, Base = 2007 Actual" for consideration as a reasonable non-power cost cap formulation that is consistent with the model approved for the VGS alternative regulation plan. *See*, Exh. CVPS-Rebuttal-PJK/RDC-6 at 2, lines 78-81; Lowry reb. pf. rebuttal, generally. Additionally, the VGS operating cost cap has an added incentive for efficient operations, which provides that Vermont Gas may increase its non-gas rates by 50% of the difference between the level of its operational costs as determined by its annual COS filing and its cap. If the Board determines that a non-power cost cap is more appropriate for CVPS than the Subcap and Unicap, the Company recommends that the Board direct that the alternative identified by Dr. Lowry and the 50% difference be combined to parallel the incentive now in effect for VGS. This alternative is based on CVPS's 2007 actual results and, as shown on Rebuttal-PJK/RDC-6, page 2, line 81, would result in a non-power cost cap that would require cost discipline but not create disallowances during the Plan rate years. If the Board requires more explanation in its consideration of this option, the Company would be pleased to respond to any Board questions.

Earnings Sharing Adjustment Mechanism

Regarding the ESAM (earnings sharing mechanism), the Department's concern with the Plan's first set of dead bands (50/50) is that they are too narrow and in effect shift financial risk associated with a below investment grade credit rating to rate payers when it appropriately

belongs with CVPS management and shareholders.

A wider set of dead/sharing bands is proposed by the Department (75 basis points above and below the allowed ROE) and would be applied when and if CVPS receives an investment grade corporate credit rating. An additional 50/50 sharing band would apply to the next 50 basis point variation in ROE.

The Department's proposal would effectively create an earnings floor, or lowest ROE the Company would earn, of 9.21%. As stated previously, the magnitude of the cost disallowances under the Department's proposed cost caps would have the Company consistently performing at or near the bottom end of the sharing bands. Aside from the disincentive this creates to control costs, the Company has presented credible evidence to be concerned about the implications of this proposal on the Company's ability to access the capital markets on reasonable terms, particularly during a period of time in which CVPS expects and needs to raise new capital.

2. Balanced Risks and Rewards

Section 218d(a)(7) requires that the Board find that an alternative regulation plan establishes "a reasonably balanced system of risks and rewards that encourage the company to operate as efficiently as possible using sound management practices." The Department asserts that the incentives in the CVPS Plan appear relatively "risk free" with respect to business and financial risk. The Company strongly disagrees.

The Plan shifts elements of cost variability from the Company's shareholders to ratepayers, because it strengthens the connections between costs and rates. This does not necessarily mean that a systematic financial risk has been shifted to consumers because the rates that would have been set in the absence of this Plan by the Board would have been set in an

unbiased manner. In other words, the decreased variability that should be expected in rates due to the closer tracking of costs should be a symmetric variability – sometimes leading to lower rates and sometimes to higher rates. This decreased variability does not necessarily represent an increased financial risk for consumers.³¹ Yet, assuming *arguendo* that the Plan were to pass additional short-term risk to customers, there is nonetheless a counterbalancing benefit as the Plan incorporates a lower ROE than would be used to set rates under traditional regulation. The power adjustor (PCAM), while passing through some costs, also incorporates an aggregate rate cap (Unicap) and power efficiency adjustment band which provides the Company with a direct incentive to mitigate power cost risks and minimize the net cost of power.³²

Also, the long-run improvement in cash flow and credit rating to the Company, will improve access to capital on favorable terms, which will produce savings for customers. Id.

Over the long-term, the approval of the Plan will reduce the risk of credit rating downgrade, which could entail additional costs for ratepayers. It should also enable CVPS to pursue a broader range of power resource options, which could provide significant value to consumers.

In summary, the Plan as a whole is beneficial to ratepayers. After consideration of the Department's arguments, the Company still believes that the risk/reward allocation is reasonably balanced. The Plan assures that the Board will receive periodic reports on Plan performance. Furthermore, the Board retains jurisdiction to review costs if necessary through an investigation under Section 227(b), or to investigate the Plan itself under Section 218d(i).

³¹ Tr. 7/9/08 at 103 (Deehan).

³² Cf Docket No. 7175/7176 Order at 33.

3. Just and Reasonable Rates

The Department argues that the Plan may not result in just and reasonable rates as required by Section 218d(a)(2). According to the Department, the formulation of the cost caps and the ESAM dead bands and sharing bands have the potential to result in unjust and unreasonable rate increases. The Department provides no specific evidentiary support to this contention with respect to the ESAM (earnings sharing proposal). With respect to the cost caps, the Department argues that they would not create enough cost discipline. For the reasons cited above, the Company believes the Department's proposed caps are unreasonable. In contrast, the Company's proposed Subcap is consistent with revenue adjustment mechanisms approved in other jurisdictions. It contains an escalation formula that is supported by a rigorous analysis of indexing data performed by a credible expert in the field.³³ In addition, the Plan provides direct incentives to manage power and non-power costs so as to achieve positive earnings results within the PCAM and ESAM dead bands. The Unicap, while designed primarily to serve consumers as a protection against unexpected rate shock, also induces the Company to hold down all costs so as to limit the potential for deferral of power costs which would harm cash flow. The Plan provides the Department with the opportunity to have an independent consultant review the annual base rate adjustment.³⁴ Furthermore, the Business Process Review report will help assure that the Company is exercising cost discipline and operating efficiently, which was the Department's stated intent when it recommended such a review. Finally, as discussed above, the Board will have continuing authority to suspend base rate filings, where the non-power costs may be the issue, or to open an investigation under Section 227(b). For these reasons, the

³³ See Lowry pf. reb. rebuttal, generally.

Department's arguments are unconvincing.

We are mindful that the initial implementation of this Plan will take a coordinated effort. There is no base rate filing for 2009 at this time. Furthermore, a November 1 base rate filing has to go through a process between CVPS and the Department for development of a cost of service, although there is no obligation on the part of CVPS to obtain the Department's approval. CVPS could file its base rate cost service for 2009 even if the Department objects so long as CVPS has given the Department the opportunity to audit the cost of service before the filing occurs on November 1. If the Department objects, the CVPS base rate cost of service could still go into effect on January 1, unless the Board decides to suspend the rate change. In that case the Board has until April 30 to decide whether to accept or reject the new base rate filing. If the base rate filing for 2009 is suspended, none of the adjustments in the Plan would go into effect since the base rate filing is necessary to set the base line for adjustments in the 2009 rate year with respect to the PCAM and ESAM. Furthermore, assuming a November 1, 2008 effective date, the Company will need guidance from the Board on whether the \$240,000 benefit to customers for the balance of 2008 (created by lowering the ROE to 10.21%) should be implemented in rates beginning on November 1 or credited to ratepayers as a regulatory liability that would offset the revenue requirement in 2009. No other Plan adjustments would be applicable for this period of November and December 2008.

VI. CONCLUSION

For the reasons set out above, we ask the Board to approve the CVPS Plan. Over its term, this alternative regulation plan has the promise of improving CVPS's financial status, while

simultaneously benefiting ratepayers. The Plan provides meaningful incentives for the Company to operate efficiently and to invest in project to improve network delivery services.

We also ask the Board to approve the MOU between the Department and CVPS with respect to implementation of an adjustment related to the Company's authorized return on equity.

The MOU calls for a decrease in the ROE of 50 basis points upon the effective date of the alternative regulation plan. In accordance with the Board's schedule in the proceedings, the Company requests November 1, 2008, as the effective date for the CVPS Plan. Furthermore, the Company requests that the Board include in its order an instruction, for administrative efficiency and rate continuity, that the value of the lower ROE for the months of November and December 2008 shall be booked in the Company's financial records as a regulatory liability and shall appear as a credit for ratepayers in the Company's Base Rate cost of service for rate year 2009.

The Company also requests that the CLF Stipulation be approved.

Finally, if the Board is considering a non-power cost cap in lieu of the Company's proposal, we respectfully request the Board adopt "Option #3" as described in Exh. CVPS-Rebuttal-PJK/RDC-6 as a reasonable non-power cost cap formulation and that it be implemented consistent with the 50% sharing model approved for the VGS alternative regulation plan.

The review of the alternative regulation plan in this proceeding has been limited to the unique circumstances of CVPS, and should not be interpreted more broadly as endorsing a similar alternative regulation plan for any other Vermont utility. Whether a similar plan would be appropriate for another utility is a determination that must be made by the Board based on the facts relevant to that particular utility. For this reason, the Order issued should not be construed as having any precedential effect, except as necessary to ensure CVPS's performance under the

Plan or to enforce an order of the Board resulting from the Plan.

VII. PROPOSED ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. CVPS's alternative regulation plan ("Plan") is approved to take effect on November 1, 2008.
2. Effective November 1, 2008, the Company shall book and defer for return to ratepayers in the 2009 rate year, the revenue reduction resulting from a decrease in the Company's ROE from 10.71% to 10.21%. This amount is calculated to be \$240,000.
3. The CLF Stipulation is approved
4. CVPS shall file tariffs in compliance with this Order by _____.
5. By November 1, 2008, CVPS shall submit to the Department a proposal for documenting and reporting the rate filings required under the Plan including but not limited to power supply costs, plant additions and capital expenditure plans and budgets in connection with base rate, power adjustor and earnings sharing adjustor changes, and will incorporate any revisions to its proposal thereafter proposed by the Department or provide a detailed explanation for not doing so. Any unresolved disputes shall be submitted to the Board for resolution.
6. Under the Docket No. 7321 MOU, the Department will retain, at the Company's expense and subject to the Company's reasonable consent, an independent third party with accounting and rate-making expertise ("Third Party") to review each base rate filing under the Plan for (1) accuracy, (2) completeness, (3) compliance with traditional rate-making and existing

Board Orders regarding cost-of-service filings including the calculation of regulated earnings and (4) consistency with the Company's actual costs and the Plan. The Third Party shall file a report with the Board and Department at the time the base rate filing is submitted to the Board.

7. The Company shall submit, within 30 days of this Order, a sample of each type of filing to be made under the Plan and the Department shall provide any comments within 30 days thereafter. CVPS shall consider in good faith any changes to the filing formats under the Plan as the Department deems to be reasonably necessary to complete an efficient and meaningful review of the filings due under the MOU. Any irresolvable issues shall be referred to the Board for resolution.

8. CVPS shall collaborate in good faith with the Department on its plans concerning customer information regarding the Plan, including Customer Service Representative training, and the timing and substance of customer communications.

9. CVPS shall collaborate in good faith with the Department to develop tariffs providing for an annual, fixed-unit-price service to commence no later than _____.

10. By _____, CVPS and the Department shall jointly develop and submit for Board approval criteria to be used in assessing the Plan's effectiveness at the end of its initial term (December 31, 2010). Neither the Company nor the Department shall be bound to support termination or extension of the Plan beyond its initial term based solely upon the criteria so developed.

11. Not later than June 30, 2009, and June 30, 2010, the Company shall file reports with the Board and Department evaluating the effectiveness of the Plan's performance in achieving the goals of 30 V.S.A. § 218d. In advance of filing the reports, the Company shall

confer with the Department with respect to the measurement criteria to be used in the reports.

12. CVPS shall describe the Plan in a separate mailing to customers at least one month prior to the first rate adjustment under the Plan and shall work with the Department in the development of customer communications and materials to be provided to customers.

Dated at Montpelier, Vermont, this _____ day of _____, 2008.

_____)	
_____)	PUBLIC SERVICE
_____)	
_____)	BOARD
_____)	
_____)	OF VERMONT
_____)	

OFFICE OF THE CLERK

FILED:

ATTEST: _____
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.

Dated in Rutland, Vermont this 8th day of August, 2008.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Dale Rocheleau', written over a horizontal line.

Dale A. Rocheleau, Esq.

Kenneth C. Picton, Esq.

Central Vermont Public Service Corporation

77 Grove Street

Rutland, VT 05701

Phone: (802) 747-5355

drochel@cvps.com

kpicton@cvps.com